BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of

CAMDEN HATHWAY

Appearances:

For Appellant: Andrew Kenetzky and Harry Murphy, Attorneys at Law

For Respondent: Burl D. Lack, Chief Counsel

O P I N I O N

This appeal is made pursuant to Section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on protests to proposed assessments of additional personal income tax against Camden Hathway in the amounts of $1,292.74, $4,877.71, $4,469.47, $2,981.95 and $985.87 for the years 1952, 1953, 1954, 1955 and 1956, respectively.

Appellant conducted a coin machine business in and around San Luis Obispo under the name of San Luis Amusement Company. He owned multiple-odd bingo pinball machines, music machines and some miscellaneous amusement machines., The equipment was placed in various locations such as bars and restaurants.

The proceeds from each machine, after exclusion of expenses claimed by the location owner in connection with the operation of the machine, were divided equally between Appellant and the particular location owner. Appellant also received a flat monthly fee from a Los Angeles man for allowing him to operate certain claw machines under Appellant's city license. Appellant did not own, install, service, or collect from the clawmachines.

The gross income reported in tax returns was the total of amounts retained by Appellant from locations. Deductions were taken for depreciation, cost of phonograph records and other business expenses. Respondent determined that Appellant was renting space in the location where his machines were placed and that all the coins deposited in the machines constituted gross income to him. Respondent disallowed all the expenses of the coin machine route pursuant to Section 17297 (17359 prior to June 6, 1955) of the Revenue and Taxation Code which reads:

> In computing taxable income, no deductions shall be allowed to any taxpayer on any of his gross income

> derived from illegal activities as defined in Chapters 9, 10 or 10.5 of Title 9 of Part I of the Penal Code of California; nor shall any deductions be allowed to any taxpayer on any of his gross income derived from any other activities which tend to promote or to further, or are connected or associated with, such illegal activities,

With respect to Appellant's coin machines, the evidence indicates that the operating arrangements between Appellant and each location owner were the same as those considered by us in Appeal of C. B. Hall, Sr., Cal. St. Bd. of Equal., Dec. 29, 1958, 2 CCH Cal. Tax Cas. Par, 201-197, 3 P-H State & Local Tax Serv. Cal. Par. 58145. Our conclusion in Hall that the machine owner and each location owner were engaged in a joint venture in the operation of these machines is, accordingly, applicable here.

In Appeal of Advance Automatic Sales Co., Cal. St. Bd. of Equal., Oct. 9, 1962, CCH Cal. Tax Rep. Par. 201-984, 2 P-H State & Local Tax Serv. Cal. Par. 13288, we held the ownership or possession of a pinball machine to be illegal under Penal Code Sections 330b, 330.1 and 330.5 if the machine was predominantly a game of chance or if cash was paid to players for unplayed free games and we also held bingo pinball machines to be predominantly games of chance.

Three location owners who had Appellant's bingo pinball machines appeared as witnesses at the hearing of this matter. Two of them testified that cash was paid to winning players for unplayed free games while the third, although having previously signed a statement admitting payouts, testified at the hearing and denied making payouts. Respondent's auditor testified that during an interview at the time of the audit Appellant stated that payouts were made on some of the bingo pinball machines and that they equalled 60 or 65 percent of the amounts deposited in those machines, but that the average of the payouts, taking into account those machines on which no payouts were made, equalled 50 percent of the total amounts placed in all of the bingo machines. At the hearing Appellant testified that he reimbursed the location owners for whatever expenses they claimed with respect to his machines but disclaimed actual knowledge of cash payouts for unplayed free games.

We conclude that it was the general practice to pay cash for unplayed free games to players of Appellant's bingo pinball machines. Accordingly, this phase of Appellant's business was illegal, both on the ground of ownership and possession of bingo pinball machines which were predominantly games of chance and on the ground that cash was paid to winning players. Respondent was therefore correct in applying Section 17297. In view of our conclusion with respect to the pinball machines, it is unnecessary

to decide whether Appellant's connection with claw machines involved illegal activity on his part.

Several of the locations had both pinball machines and music machines. Appellant and his employee collected from and serviced all types of machines. Appellant's coin machine business was highly integrated and we find that there was a substantial connection between the illegal activity of operating bingo pinball machines and the legal activity of operating music machines and miscellaneous amusement machines. Respondent was therefore correct in disallowing the expenses of the entire business.

There were not complete records of amounts paid to winning players on the bingo pinball machines and Respondent estimated these unrecorded amounts as equal to 50 percent of the total amount deposited in such machines. Respondent's auditor testified that the 50 percent payout figure was the estimate given to him by Appellant during an interview at the time of the audit. The only other evidence on this point is an estimate made by one location owner at the hearing of this matter that the payouts on bingo pinball machines in his establishment equalled one-third of the amounts deposited in the machines.

As we held in the Hall appeal (supra), Respondent's computation of gross income is presumptively correct. In our opinion, there is no adequate evidence to alter the payout figure used by Respondent.

In connection with the computation of the unrecorded payouts, it was necessary for Respondent's auditor to estimate the percentage of Appellant's recorded gross income arising from multiple-odd bingo pinball machines since all machine income was lumped together. Respondent's auditor testified that he had used the estimates obtained from Appellant in attributing 65 percent of Appellant's recorded gross income to bingo pinball machines. In the absence of other information in this regard, we can see no reason to disturb this allocation.

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 18595 of the Revenue and Taxation Code, that the action

of the Franchise Tax Board on protests to proposed assessments of additional personal income tax against Camden Hathway in the amounts of $1,292.74, $4,877.71, $4,469.47, $2,981.95 and $985.87 for the years 1952, 1953, 1954, 1955 and 1956, respectively, be modified in that the gross income is to be recomputed in accordance with the opinion of the Board. In all other respects the action of the Franchise Tax Board is sustained.

Done at Pasadena, California, this 21st day of October, 1963, by the State Board of Equalization.

John W. Lynch, Chairman

Geo. R. Reilly, Member

Paul R. Leake, Member

Richard Nevins, Member

_____, Member

ATTEST: H. F. Freeman, Executive Secretary